



RAYMOND YEUNG

# CHINA'S TRUMP CARD

CRYPTOCURRENCY  
AND ITS GAME-CHANGING  
ROLE IN **SINO-US TRADE**



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# **CHINA'S TRUMP CARD**

## **CRYPTOCURRENCY AND ITS GAME- CHANGING ROLE IN SINO-US TRADE**

**RAYMOND YEUNG**

**WILEY**

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*To all the victims who have suffered from the deadly coronavirus. To all the medical heroes who fought selflessly in the front line.*

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All views expressed in this book are neither my employer's nor the aforementioned parties. All errors are solely my responsibility.



## About the Author

**Raymond Yeung** graduated with a PhD in Economics from Queen's University in Canada and is a holder of the Financial Risk Manager (FRM) certification. He began his economist career one week prior to the Asian Financial Crisis in 1997. He is currently Chief Economist Greater China at Australia and New Zealand Banking Group Limited (ANZ), leading an award-winning team covering the region's macroeconomic and financial market research. His insights have received strong following, including institutional investors, corporate treasurers, and central banks. He speaks frequently in industry conferences and shares his views on Bloomberg, Financial Times, CNBC, Di Yi Cai Jin, and Caixin. Prior to joining ANZ, Raymond was Deputy Head of Economic Research Asia at Swiss Re. He is a Council member of China Chief Economist Forum and a columnist in the Chinese media.

## Preface

When I submitted the manuscript to the Wiley team, China and the rest of the world were battling against the COVID-19 pandemic. To prevent the virus from spreading, the Chinese government imposed a lockdown policy unprecedentedly. Economic activity was weighed down acutely. Supply chains were interrupted. The global situation was also alarming as the virus cases soared in other countries, including the US. In response to the negative economic impact, the Federal Reserve reduced policy interest rate to zero and restarted quantitative easing. Other central banks also followed the Fed and eased their monetary policy.

The virus shock represented an unpredictable “Black Swan” event in a fashion similar to Trump's initiated trade war. When the 45th US president took over the White House in early 2017, not too many people treated his “America First” claim seriously. His tweets, his tariff, and his “friendship” with president Xi Jinping stirred up market volatility. When he started the trade war in 2018 shortly after hosting Xi in Florida, exporters were caught off guard. Many people in the financial markets regarded the trade war as the “black swan” of the year.

In this book, however, I argue that this US-China trade war is not a black swan. Unlike coronavirus, the trade tension is predictable. When the trade war was looming in July 2017, a high-profile editorial in *People's Daily* warned that China should be on guard against not only the black swan but also the “grey rhino.” The Chinese government was pointing the latter to the lingering concern of a financial bubble, equivalent to a national security issue as I interpreted in a Bloomberg interview on July 19, 2017.

“Grey rhino,” a concept coined by Michele Wucker in light of the Global Financial Crisis (GFC), refers to event risks that are impactful, obvious, and predictable. To Wucker, the US housing bubble in 2008 should have been foreseeable. The crisis was due to policymakers' lack of guts to right the wrong. When the GFC broke out, the market thought it was random and unpredictable. In hindsight, the policymakers should have noticed the danger and fixed it.

Likewise, the tension between the US and China was so obvious. The trade war was a “grey rhino.” Three years prior to the GFC, Ben Bernanke agreed that the rising US current account deficit stemmed from a global saving glut. What he did not admit was that the only way to stop it was to take away the “exorbitant privilege” of the dollar. The then chairman of the US Fed printed money seemingly unlimitedly to save the US financial markets. China stocked up the US government debts and funded the ever-widening US-China trade gap. Trade imbalance was actually a monetary phenomenon. People said the trade war was a “black swan.” Beneath the swan's feathers was actually a “grey rhino.”

This book proposes a way to break the tie between the China-US trade imbalance and the global addiction to the US dollar, i.e. an outcome of the Triffin Dilemma. As the trade war is the onset of deglobalization, de-dollarization inevitably becomes a natural consequence. Cryptocurrency signals the need to reform the global monetary system. Just when China and the US are competing in the technological realm, Blockchain provides a perfect alternative to the current system of global foreign reserve. In 2009, Zhou Xiaochuan requested a reform of the dollar-based regime. In 2019, Mark Carney responded to his question and agreed to develop a “synthetic hegemonic currency.”

**In the first chapter**, I review the causes, the impact, and the outlook of the trade war. On the surface, the US was frustrated with China's track record of intellectual property rights and forced technology transfer, offering an excuse for the US to act. However, behind the conflict seemed to be the clash between the ideologies of "China Dream" and "America First." Import tariff is just smoke and mirrors. The US administration decided to attack the global supply chains. Prohibiting US companies from business transactions with some Chinese companies could paralyze their production line. It was an alternative way to drag China's exports to the US. This trade war is unconventional.

In [Chapter 2](#), I argue that, no matter how unconventional they are, the trade measures and even trade agreements cannot reduce US current account deficits. Due to the "exorbitant privilege" of the US dollar, the US lacks an incentive to manage its fiscal and external balances. China, a country having USD 3 trillion of savings in foreign currency, has recycled its export surplus into US dollar assets. This loop, I call it "factory dollar recycling," resembles what oil-exporting countries have been doing after the Nixon shock. Even without gold backing, the US dollar continues to secure the advantage of network externalities. The problem of trade imbalance is chronic. Neither import tariff nor currency revaluation can fix it.

Is the leading position of the US dollar unshakable? [Chapter 3](#) searches for an answer from history. The interchanging position between pound sterling and the dollar in the Interwar Period offered many important insights. In my discussion, I stress that globalization, financial integration, and dollarization are interlinked. When deglobalization begins, as the trade war is signaling, populism and protectionism also question the role of financial integration, especially after a financial crisis. As

the global market is divided, the dollar's monopolistic position is not invincible.

Naturally, the protagonist in the trade war is the one eager to de-dollarize, as I explain in [Chapter 4](#). In 2005, China began to unpeg the renminbi from the greenback. In 2009, the authorities kicked off a high-profile campaign of currency internationalization. By Mundell's impossible trinity, a more flexible exchange rate regime will allow China to hold less foreign reserve. Using the yuan as a trade currency also allows China to distance itself from the US dollar. This policy preference may also be revealed by the currency allocation of China's sovereign wealth funds. Contrary to the topic of RMB internationalization, China's reserve management has not received much coverage in the existing literature. But it is a critical part of reforming the global monetary regime.

After the Nixon shock, the US secured the fate of its currency through semi-pegging with Saudi Arabia's oil reserve. In the twenty-first century, what kind of tie should the Chinese yuan develop? In [Chapter 5](#), I argue that technological development is the only way for the country to beat the middle-income trap. "Go digital" is a development strategy many countries have adopted in order to stay competitive. China has already held a leading position in e-commerce and internet connectivity. Belt and Road (supposedly) has become an opportunity to extend this connectivity globally. In the last few decades, petroleum was backing the global influence of the US dollar. In digital times, 5G will very likely support China's total factor productivity. In this century, China's position in the digital economy defines the value of the renminbi.

Can the Chinese yuan replace the US dollar in the digital economy? The answer is "possibly." The pound lost its global position after a series of shocks during the Interwar

Period. Similarly, another shock is required to trigger a reform in the international monetary system. In my view, blockchain is the trigger. In [Chapter 6](#), I offer my two cents on cryptocurrency from an outsider's point of view. My wish is for the readers to appreciate that, based on blockchain, cryptocurrency is technically capable of being a secured form of payment. My discussion in this chapter focuses on the micro foundation of cryptocurrency. In contrast to our money-and-banking system, distributed ledger technology is disintermediating. The architecture is completely different from sovereign money, be it the yuan or the US dollar. However, distributing the trust across participating members does not disqualify its legitimacy as a form of money.

In [Chapter 7](#), I lift the discussion of cryptocurrency to the macro level. The international monetary system is sovereign-based. The system is rule-based, as the Balance of Payment Manual states the foreign reserves have to be denominated in currency of the legal tender. Well, gold is exceptional. But, in my view, there is no reason not to expand the list of exceptions. Facebook's introduction of Libra has prompted regulators to quicken the development of central bank digital currency. Zhou's request was met with a cold shoulder. Satoshi Nakamoto's invention was regarded as a cult. Eventually, Carney's call for going digital will likely receive a red-carpet treatment.

In the **final chapter**, I propose a practical solution that takes Carney's idea one step forward. The digital currencies issued by different central banks are largely an electronic version of M0. They are still fiat money. To preserve the spirit of blockchain, global policymakers should develop an official cryptocurrency that can also overcome some operational issues of private coins, such as governance of reserve or AML/CTF. I name this coin the World Crypto Currency (WCC). Given its official status, the

WCC could also be a reserve currency for China to consider. Don't be afraid, China. The new system will facilitate your reserve diversification. The WCC is not a yuan competitor. It is a venue to support the value of the renminbi.

Lastly, I definitely need to underscore certain caveats here. This book is perhaps the first attempt to integrate several seemingly unrelated economic topics into a single coherent theme: the US-China trade war, the economic history of globalization, digital economy, cryptocurrency, and monetary economics. My broad and superficial knowledge does not qualify me an expert in any of them. The thoughts presented in this book do not form any base for an investment recommendation. I do not have personal holdings in cryptocurrency (as of March 2020). My hope is for this book to offer some food for thought in the era when the new international economic order begins.

# Chapter 1

## An Unconventional Trade Feud

### 1.1 Thanos and Trump

Beware readers, spoiler alert ahead.

*“I thought by eliminating half of life, the other half would thrive ... with the stones you've collected for me, create a new one teeming with life that knows not what it has lost but only what it has been given. A grateful universe.... I am inevitable.”*

*Thanos, Avengers: Endgame.*

On June 20, 2018, I came across an interesting headline, “Avengers star Josh Brolin explains how Trump is similar to his ‘Infinity War’ villain Thanos,” on an online business magazine.<sup>1</sup> In his interview with Stephen Colbert, Brolin hilariously read Trump's tweet in Thanos's tone. The Hollywood star, whose character erased half of the galaxy's population to fulfill his own political belief, said Trump's public policies were akin to what Thanos did in the Marvel trilogy. His own planet, Titan, ran out of resources due to overpopulation. In response, Thanos thought the resource imbalance problem facing the universe could be addressed through massacring half of the creatures. He was addressing an economic problem. He tried to search for an equilibrium, and he called it “balance.” “When I'm done, half of humanity will still exist. Perfectly balanced, as all things should be.”

What was Thanos's plan? The *Avengers* villain offered “a peaceful way” to finish people's lives painlessly and indiscriminately. He collected six Infinity Stones, snapped



his fingers, and turned many superheroes into ashes—a very sad ending, surprising the audience that walked out of the cinema. Handling the Infinity Stones was not an easy task. The gems were full of gamma rays. Anyone who held the stones needed a strong will to do so. Thanos believed he was the chosen one to fulfill his “destiny.” He said, “I'm the only one who knows that. At least I'm the only who has the will to act on it.” He even sacrificed his beloved daughter Gamora in exchange for the soul stone. “The hardest choice requires the strongest will.” Do Thanos's words sound like a president who claimed he was the designated one to lead his country to greatness again?

Donald Trump thought flagging a trade war could restore the trade balance of the US. He could order his administration to severely penalize China. Lifting import tariff rates from 0% to 25% on Chinese goods in a flash caught the world off guard. Half a million factory workers were affected. China was labeled a currency manipulator even though every-one knew the country actually wanted a stronger rather than weaker currency. Trump's trade measures hurt many American companies and US consumers. But he did not care. He had a strong will like Thanos and he decisively went his own way. “We reject globalism and embrace the doctrine of patriotism,” he said, delivering his second address to the United Nations in November 2018.<sup>2</sup>

At the same time, there are still believers in free trade. Germany, Canada, Mexico, Korea, Japan, and other countries have risen to prosperity in the past few decades. They prefer globalization of some sort. The G20 Summit in Hamburg 2017 issued a heroic declaration to defend the prevailing international arrangement: “Globalization and technological change have contributed significantly to driving economic growth and raising living standards across the globe. However, the gains from globalization

have not been shared widely enough. By bringing together developed and emerging market economies, the G20 is determined to shape globalization to benefit all people. Most importantly, we need to better enable our people to seize its opportunities.”<sup>3</sup>

China was the top winner in globalization. In 1979, the Middle Kingdom decided to open up, fueling the world with a massive supply of labor. After 40 years of strong growth, the country became the production line for the world, receiving orders from the US, Japan, and Europe. Its ability for mass production was unchallengeable. The quality and technological content of Chinese products improved rapidly in the past few years. It began to develop its own brand. China became a prime target of Trump's new trade policy.

Meanwhile, China was also faced with many structural economic issues, namely a notably aging population and debt pileup. President Xi Jinping saw the urgency to upgrade the economy. He wanted China to become a tech-driven economy by the middle of this century. His “China Dream” was seen as a threat to the Western-centric world. Xi vowed to bring prosperity to Eurasia via his Belt and Road campaign. He played as a champion for globalization. He wanted more countries to use the renminbi (RMB). Perhaps Trump thought if he didn't stop China now, it would be too late. Maybe the trade war was meant to safeguard the global dominance of the US. Whatever his initial motivation, the battle has begun. A new economic order is evolving.

This chapter reviews the causes, the impact, and the outlook of the trade war. In [Section 1.2](#), I discuss several possible reasons for the trade war. Trump's policy stance clearly showed a discontent with globalization. All the disputes he created with other countries pointed to a rising era of unilateralism and neo-nationalism. Since China

represented almost two-thirds of the US total trade imbalance, treating China harshly was tactical. The US was frustrated with China's track record of intellectual property rights and forced technology transfer. This seemed to offer a legitimate reason for the US to act. However, underlying the trade tension appeared to be a rivalry between the China Dream and America First. China threat theory has become increasingly popular under the current political climate.<sup>4</sup> In a nutshell, the trade war is not an issue of trade imbalance.

[Section 1.3](#) identifies the features of this conflict. Compared with other trade disputes, this US-China trade war is unconventional. An import tariff only serves as an appetizer but is not the main course itself. The US administration clearly understands how globalization works and decides to attack the global supply chains. Prohibiting US companies from business transactions with some Chinese companies can paralyze their production line. China can also retaliate by limiting the supply of rare earth. The tit-for-tat actions of both countries are strategic, calculative, and innovative.

In [Section 1.4](#), I propose the possible outcomes of this trade war. The central theme of this book is that trade measures will not address the fundamental causes of the US trade imbalance. Import tariffs and investment restriction will hurt the economic interest of the US as importers will probably pass the cost to consumers. China will hedge the risk of excessive trade exposure and focus on developing its domestic economy. Europe and Japan would benefit from a closer economic tie with China. Trump's policy, which aims to make "America great again," would probably backfire on his country.

## **1.2 What Causes the Trade War?**

### **1.2.1 Trump's Unilateralism**

We have probably reached an inflection point in modern economic history. As the world's economic superpower, the US decided to change its course. After President Donald Trump took over the White House, his administration changed its approach to dealing with global economic affairs. The 45th president of the US paid no respect to the prevailing international order that seemed to have functioned well. Immediately taking over the White House, the US was pressing Mexico and Canada to renegotiate the North American Free Trade Agreement, one of the most significant trade bloc agreements in the world since 1994. Stepping into the second year of his tenure, his administration embarked on a trade war with China. By citing that China had stolen American jobs, the populist president posed a serious challenge not only to the trade partners of the US but also the long-held belief in globalization of other countries.

With hindsight, Trump's trade policy shouldn't have surprised anyone. In the early days of his election campaign, the Republican candidate had already revealed his controversial plan to build a “great wall” along the US–Mexico border. He wrote a two-page memo to the *Washington Post* in March 2016 and vowed to execute his plan to build a 1,000-mile border fence.<sup>5</sup> He threatened to halt remittance transfers to Mexico, sent by Mexican immigrants in the US, which amounted to nearly USD 25 billion a year. Trump said the border wall that would cost USD 8 billion should be paid for by the Mexican government. In addition, he also planned to restrict Mexican imports, halt legal immigration, and increase fees for visas and green cards. On the issue of illegal immigrants he said, “We have the moral high ground here, and all the leverage.”

In the past few years, the world has witnessed his unconventional approach to managing economic affairs by the populist ideology. He evaluated the positions of his counterparty and his own in a holistic manner. The bilateral issues under his radar were not necessarily confined within trade and investment. In his game, everything, such as climate change and international security, could be monetized and bargained. Typically, American politicians saw North Korea as a national security issue. But Trump said he would consider withdrawing US military stationed in South Korea unless the latter paid for the defensive support. In his campaign, he described the US-Korea Free Trade Agreement that was launched in 2007 as a “job-killing trade deal.” He began to renegotiate this shortly after his arrival at the White House.

Many political scholars suggested that Trump's “America First” could be inherited from the unilateralist-isolationist tradition dating back to the 19th century. Trump's presidential election might mirror the surge of a “Jacksonian,” or populist, view of world politics (Mead [1999](#)). The Jacksonian approach combined elements of ethno-nationalism, anti-elitism, and strong commitment to the values of the American “folk community.” This approach tended to see the US as a loser in opening the economy to the world.<sup>6</sup> Nonetheless, the development in the past few years indicated that unilateralism had been increasingly adopted by some governments in dealing with global affairs. Hirsh ([2016](#)) warned that the global trend of neo-nationalism would continue to last, as there was a parallel development not only in Trump's trade policy but also Boris Johnson's attitude in Brexit.

The Jacksonian stance was well reflected by the list of international agreements withdrawn by the US (Fehl and Thimm [2019](#)). They included the Paris Agreement on Climate Change, the UN Human Rights Council, and the

UN Educational, Scientific and Cultural Organization (UNESCO) to more obscure treaties such as the Universal Postal Union. In his 2017 and 2018 speeches at the UN General Assembly, Trump announced his unrelenting position to “defend America's interests above all else”<sup>7</sup> and “choose independence and cooperation over global governance, control, and domination.”<sup>8</sup> This was probably one of the most undiplomatic expressions ever voiced from any US president. Trump also threatened to withdraw the US from the World Trade Organization (WTO), stating that “If they don't shape up, I would withdraw from the WTO” and claimed that “[the US] lose the lawsuits, almost all the lawsuits in the WTO.”<sup>9</sup>

Trump's anti-multilateral approach shocked his US allies in Asia-Pacific. He walked away from the Trans-Pacific Partnership (TPP) trade agreement. The trade pact, originally proposed by a group of Pacific countries back in 2016, was considered a move to counter China's growing influence in the region.<sup>10</sup> Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and the US (President Barack Obama) signed the deal on February 4, 2016. After Trump's withdrawal, the agreement could not enter into force. In December 2018, the remaining signatories renamed the new deal as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, forming a trade pact of much smaller scale without the participation of the US and China.

As a unilateralist, Trump believed the US could gain more from squeezing the last penny from other countries' wallets. He dealt with every country individually. Sachs (2018) pointed out that Trump's policies were based on a mindset of zero-sum game. Even though free trade helped the world reach another equilibrium at which the US has gained more, the unilateral approach might have held